



Testimony of

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Before a hearing of the

Senate Special Committee on Aging

**on the Equal Employment Opportunity Commission's recently
released final rule on the treatment of retiree health benefits under
the Age Discrimination in Employment Act (ADEA)**

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Good afternoon Senator Breaux and members of the Committee. Thank you for the opportunity to appear this afternoon. I am James Klein, President, of the American Benefits Council, which is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans covering more than 100 million Americans.

The Council is pleased that the Committee is holding this hearing to examine the Equal Employment Opportunity Commission's (EEOC) final rule on the treatment of retiree health benefits under the Age Discrimination in Employment Act (ADEA). The Council strongly supports the EEOC's final rule and believes it will serve to clarify that the long-standing practice of coordinating employer-provided retiree health coverage with eligibility for Medicare or a state-sponsored retiree health benefit program is not age discriminatory and does not violate the ADEA. This clarification will help prevent older Americans from losing their retiree health coverage and will stabilize employer-sponsored retiree health benefits that are rapidly eroding.

Rapidly rising health care costs, unfavorable accounting treatment of retiree health obligations, and the lack of federal policies designed to encourage employers to provide retiree health benefits have all played a major role in the

significant decline of employer-sponsored retiree health benefits for millions of American workers. Over the past 15 years, there has been a well-documented decline in the share of employers offering retiree health benefits, dropping from 66 percent in 1988 to 38 percent in 2003.¹ This trend is likely to continue. Retiree health plan costs increased 16 percent between 2001 and 2002, while costs increased 13.7 percent for active employees, and many employers are quickly reaching the caps they imposed on their retiree health spending following the adoption of Financial Accounting Standards Board (FASB) Statement No. 106 on “Employers’ Accounting for Post-retirement Benefits Other Than Pensions”.²

Retiree health benefits sponsored by employers are generally in one of two forms. This coverage serves either as a “bridge” benefit available to early retirees that terminates once the person reaches Medicare’s eligibility age or, for those who are age 65 or older, as a supplement to Medicare benefits. Typically the pre-Medicare retiree will continue in the same employer plan that covers the active employees. Retiree health plans that supplement Medicare for retirees age 65 and older typically provide benefits not covered by Medicare, such as prescription drugs, or provide financial assistance with premiums, deductibles or co-payments. It is important to note that these plans are intended to meet distinctly different retiree health care needs and are not generally intended, nor

¹ Kaiser Family Foundation and Health Research and Educational Trust, “Employer Health Benefits 2003 Annual Survey”, Section 11: Retiree Health Benefits, Exhibit 11.1: Percentage of All Large Firms (200 or More Workers) Offering Retiree Health Benefits, 1988-2003.

² Hewitt Associates, “Health Care Costs Increases Expected to Continue Double-Digit Pace in 2003,” press release, October 14, 2002, based on data from the Hewitt Health Value Initiative.

required, to provide the “same” benefits to early retirees as they do to post-65 retirees.

Background on *Erie County Retirees Association v. The County of Erie*

In *Erie County Retirees Association v. The County of Erie*, the Court of Appeals for the Third Circuit held that an employer that voluntarily provides retiree health benefits may be prohibited from reducing retiree health benefits for individuals eligible for Medicare. In reaching its decision in August 2000, the Third Circuit overturned a District Court holding that was clearly supported by the relevant legislative history. The federal law in question in the *Erie County* case is the Age Discrimination in Employment Act (ADEA), as amended by the Older Workers Benefit Protection Act of 1990 (OWBPA).

The facts of the *Erie County* case were as follows. In 1997, the County redesigned its retiree health benefits plan and Medicare-eligible retirees began to receive their benefits largely through an HMO. The County’s pre-Medicare retirees generally continued to receive benefits through a point-of-service plan. A group of the County’s Medicare-eligible retirees sued. Among other things, the retiree group alleged that: the HMO benefits were inferior to the point-of-service benefits (even in conjunction with what the Medicare program covered), the

Medicare-eligible distinction was an illegal age-based distinction, and that the program could not meet the “equal cost or equal benefit” test.³

The trial court concluded that ADEA “clearly was not intended to apply to retirees ... who premise their complaint on alleged disparities in their retirement health benefits based on Medicare-eligibility.”⁴ The Third Circuit rejected that view and remanded the case to the trial court to determine whether the employer, Erie County, Pennsylvania, could prove that its program fit within the law’s “equal cost or equal benefit” safe harbor. In its instructions, the court said the “equal benefit” prong could be met if the sum of what Medicare provides plus what the employer provides to the Medicare-eligible retirees equals or exceeds what the employer provides to pre-Medicare retirees. But the “equal cost” prong can look solely at what the employer pays (rather than what Medicare pays plus what the employer pays). The Third Circuit essentially concluded that an employer must spend equal amounts for early retirees and Medicare-eligible retirees, without regard to what is provided by Medicare unless the aggregate benefits are identical.

³ 29 U.S.C. 623(f)(2)(B)(i). The “equal cost or equal benefit” rule states, in the pertinent part, that it is not unlawful for an employer to provide different benefits under an employee benefit plan “where, for each benefit or benefit package, the actual amount of payment made or cost incurred on behalf of an older worker is no less than that made or incurred on behalf of a younger worker, even though the older worker may thereby receive a lesser amount of benefits or insurance coverage.” (Emphasis added.)

⁴ *Erie County Retirees Association v. County of Erie*, 91 F. Supp. 2d 860, 880 (W.D. Pa. 1999).

While the Medicare-eligible Erie County retirees technically “won” their case, it was a pyrrhic victory. The result in the *Erie County* case was that the employer felt compelled to reduce benefits for pre-Medicare retirees to protect itself from violation of the ADEA, without any increase in benefits for Medicare-eligible retirees as the plaintiffs desired. This is exactly the scenario legislators were attempting to *avoid* during consideration of the OWBPA in 1990.

Federal Legislative History and EEOC Action

In 1990, after the Senate Labor and Human Resources Committee reported its version of the OWBPA (S. 1511), concerns were raised that the bill could cause the practice of coordinating retiree health benefits with Medicare to be considered age discriminatory under the ADEA. For example, when the bill was debated on the Senate floor, Senator Charles Grassley (R-IA) observed that companies provide health insurance coverage for retirees, but often cease such insurance coverage when the retiree becomes eligible for Medicare, and asked whether such programs would violate the proposed law. As Senator Orrin Hatch (R-UT), one of the managers, explained, “Many employers continue health benefits for persons who retire before they are eligible for Medicare and/or continue certain benefits that are supplemental to Medicare ... this compromise ensures that the bill will not interfere with these important benefits that are vital to retirees of all ages.”⁵

⁵ 136 Cong. Rec. S13 297-98 (daily ed. Sept. 18, 1990).

Senator Grassley's concerns were further addressed when the Senate voted to pass a final substitute version of the bill. The Statement of Managers on the final version of the OWBPA is explicit that the practice of taking Medicare eligibility into account in structuring retiree health benefits is not prohibited. When the bill was presented in the House of Representatives, Representative Bill Goodling (R-PA) introduced into the record a summary of the improvements in the final version of the bill, including a clarification that "employers are not required to provide equivalent retiree health coverage to Medicare eligible and pre-Medicare eligible retirees."⁶ The legislative history confirms that the OWBPA was never intended to interfere with employers' practice of coordinating retiree health benefits with Medicare eligibility. The Third Circuit even acknowledged that a substantial amount of legislative history is in conflict with its own decision.

Employers, state and local governments and labor unions have all relied on explicit legislative history concerning ADEA. It has long been widely understood that the law permitted them to provide health benefits solely to pre-Medicare retirees or to coordinate retiree health benefits with Medicare. After the *Erie County* decision in August 2000, the EEOC adopted the ruling as its national enforcement policy. A year later, after hearing from organized labor, state and local governments, employers and others, the Commission

⁶ 136 Cong. Rec. H 8628 (daily ed. Oct. 2, 1990).

unanimously voted to rescind those portions of its Compliance Manual that discussed the *Erie* County decision. The Commission realized that requiring employers to attempt to meet the “equal cost or equal benefit” test would be complex and costly, particularly since employers could avoid the exercise by simply eliminating retiree health benefits entirely, since they are voluntary, or by reducing the retiree health coverage for early retirees.

In July 2003, the EEOC published a Notice of Proposed Rulemaking (NPRM) proposing to create a narrow exemption from the prohibitions of ADEA for the practice of coordinating retiree health benefits with eligibility for Medicare or a comparable state health benefits program. On April 22, 2004, the EEOC finalized the proposed rule making it clear that it agrees with employers and unions that the practice of coordinating employer-provided retiree health coverage with eligibility for Medicare should not be considered a violation of the federal age discrimination law. The EEOC correctly concluded that doing so would be contrary to the interests of retirees because it would result in a significant decrease, not enhancement, of health care coverage to retirees.

Opportunities to Reverse Retiree Health Coverage Trends

The EEOC’s final rule is critically important to retirees, particularly early or pre-Medicare eligible retirees who would likely face significant reductions in their early retiree health benefits if the Commission did not act. Finalizing the

proposed EEOC rule will however assist at least somewhat in stabilizing the retiree health benefit system and ensure that retiree health benefits remain available for future retirees in years to come. But the EEOC's action is stabilizing an *eroding* retiree benefits system. In all likelihood the enormous cost pressures on the health care coverage system will lead to a continued decrease in coverage for both pre- and post-65 retirees for some time to come. To reverse these trends what is needed are new savings mechanisms to encourage more retiree medical coverage opportunities. For example, the Council has been working on a proposal to establish Retiree Medical Benefit Accounts (RMBAs) that would use existing individual and workplace savings under 401(k) and IRA plans to allow individuals and workers to elect annually to allocate a portion of their pre-tax retirement contributions into a separate RMBA within their retirement plan. Distributions from a RMBA would be tax-free and penalty-free if made after a certain age and used for "medical care" as defined in Sec. 213(d) of the Internal Revenue Code.

In addition, the new Health Savings Accounts (HSAs) created under the Medicare Modernization Act of 2003, are also tax-preferred savings vehicles that may be used for retiree health and hold some promise. The Council believes the RMBA or some other vehicle devoted *entirely* to retiree health savings is still needed and we will continue to promote the concept. One change to HSAs that would be helpful would be if early retirees were allowed to use funds from their

HSA accounts to purchase retiree health insurance, rather than prohibiting the availability of HSA funds for this purpose, as under current law, for those who have not yet reached age 65.

The Council also supports bipartisan legislation aimed at encouraging employers to establish more flexibility in the use of defined benefit and defined contribution retirement plans to meet retiree health care needs. The “Pension Preservation and Savings Expansion Act of 2003” (H.R 1776), introduced by Representatives Rob Portman (R-OH) and Ben Cardin (D-MD), includes a provision (section 1401) that would allow retirees to elect to use retirement plan distributions on a pre-tax basis to pay their share of the cost of retiree health plan coverage (including coverage under a qualified long-term care insurance contract).

The “Portman-Cardin” bill also includes a proposal (section 1402) that would expand so-called section 401(h) accounts used to fund retiree health benefits. Section 1402 of H.R. 1776 would expand section 401(h) accounts so that they could be maintained as part of a profit-sharing or stock bonus plan and not just as part of a defined benefit pension plan or a money purchase pension plan, as is the case under current law. This expansion would encourage more employers to consider this option to fund retiree health benefits.

In closing, the Council strongly supports the EEOC's decision to finalize its rule exempting from ADEA the coordination of employer-sponsored retiree health benefits with Medicare. This action is critically important and will help arrest the trend of older Americans losing retiree health coverage. The EEOC regulation provides reassurance to employers and labor unions and retirees that the longstanding practice of taking Medicare eligibility into account in structuring retiree health programs is not age discriminatory but instead benefits retirees of all ages. The rule is consistent with Congressional intent and the legislative history of the law and will help the effort to prevent further significant reductions in the health benefits provided to retirees, particularly those not yet eligible for Medicare who have no other health care coverage.

Thank you for the opportunity to testify today.